

OPERATIONAL AUDITING AND STANDARDS FOR THE PUBLIC SECTOR

By



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This subject is a very comprehensive one for the timeframe that we have available for it. The most that I can do is to touch on a few highlights from the standpoint of governmental auditing, particularly as carried out by the General Accounting Office.

The term "operational auditing" has no generally accepted definition. It is usually used to refer to a scope of auditing which examines and evaluates the operating, managerial, or administrative performance of an activity or organization beyond that required for an audit of accounts and financial statements. The primary purpose of such extended auditing is to identify opportunities for greater efficiency and economy and for improved effectiveness in carrying out procedures and operations. The basic objective is two-fold: better information for managers and decisionmakers and improvement of one kind or another in relation to the goals of the organization.

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LITERATURE ON OPERATIONAL AUDITING

There is some useful published literature on operational auditing, although there are as yet no really good textbooks on the subject. For those wishing to examine some of the better writings, I can refer you to a compilation of 17 such articles carefully selected by the Northern Virginia Chapter of the Federal Government Accountants Association. This compilation was published in June of this year under the heading "Auditing--Operational-Management-Performance-Effectiveness."

The AICPA Committee on Auditing for Federal Agencies, chaired by Karney Brasfield, included a short discussion of the subject in its "Suggested Guidelines for the Structure and Content of Audit Guides Prepared by Federal Agencies For Use by CPAs," published earlier this year. This material should be of especial interest to practicing CPAs since it undertakes to analyze the nature of operational auditing in relation to the traditional approaches of the CPA to auditing of financial statements and operations.

AUDITING STANDARDS

About two months ago the Comptroller General of the United States published a statement of comprehensive auditing standards for governmental operations.¹ These standards embrace an expanded scope of auditing and what we are calling here today operational auditing. These standards specifically provide that the full scope of an audit of a government program, function, activity, or organization should encompass these three areas:

1. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
2. A review of efficiency and economy in the use of resources.
3. A review to determine whether desired results are effectively achieved.

As CPAs, we are well acquainted with our generally accepted auditing standards. We know what they mean and what kind of auditing they were developed to cover. Over the years these standards evolved as applicable to examinations which lead to professional opinions on the fairness of financial statements.

¹"Standards for Audit of Governmental Organizations, Programs, Activities and Funds," by the Comptroller General of the United States, 1972.

In government operations an audit of financial statements, which includes an examination of financial transactions and accounts, is only a part of the underlying need for an independent audit. Furthermore, it is seldom the most important part of that need. More important to government administrators and legislators, as well as the public that puts up the funds to pay for governmental activities, are independent evaluations of what is done with the money. They are interested in assessments of questions such as these:

- Are public funds really being used for good and needed purposes?
- Is money being wasted by inefficient use or operations or by spending for unnecessary purposes?
- Is anything being accomplished or is enough being accomplished?
- How good a job is being done?

In a broad sense, these questions are financial questions. But they are also operating or management questions. Auditors whose main concern is auditing accounts and financial statements cannot shed much light on questions such as these.

Thus, the need evolves for an expanded scope of auditing and a framework of auditing standards that will embrace such an expansion.

Development of the Standards

A vigorous effort was started under GAO leadership a couple of years ago to construct such a framework. This effort involved the assistance of representatives of other Federal agencies as well as State and local governments and numerous other organizations, including the American Institute of CPAs.

GAO took the lead in this effort primarily for three reasons:

1. It saw the need and had the background of experience and the resources needed to proceed.
2. No other organization was in position, or seemed to be inclined, to do the job.
3. As the central independent auditing organization in the vast structure of the Federal Government, GAO has a very strong interest in bringing about effective management systems including adequate audit systems wherever Federal funds are employed.

Those of you who are familiar with the Federal budget, now running at about \$250 billion a year, will be quick to recognize that a very substantial part of it is turned over to other organizations to help them finance programs and activities of one kind or another. The largest single category of such expenditure is the whole area of financial assistance to State and local governments--a class of expenditure that now amounts to some \$40 billion for a wide spectrum of assistance in such fields as welfare, highway construction, housing, education and manpower training, health, agriculture, and environmental protection.

Recognizing that by itself GAO cannot audit everything that the Federal Government is involved in directly or indirectly, it saw the need to proceed with a project that would help upgrade the quality and expand the nature of audit work performed irrespective of who did it. As a by-product, it was also felt that conflicting and duplicating audit work could be reduced.

BENEFITS

Several other purposes will be served by having a more comprehensive body of auditing standards:

1. They provide goals to shoot for in making improvements in auditing policies, procedures, and practices in all audit organizations concerned with the audit of governmental activities.
2. Better evaluations will be obtained on performance of public programs and activities and on accountability for the public funds and other resources used in them.
3. Information resulting from such evaluations will enable executive and program managers as well as legislators--at State, local, and Federal levels of government--to more effectively carry out their responsibilities.
4. Auditing arrangements involving auditors from different tiers of government can be simplified.
5. Agreement on auditing standards and closer adherence to those proposed will provide a better basis for reliance by Federal agencies on the audit work performed by or for State and local governmental bodies.

It is intended that these auditing standards will apply in the audit of Federal grant and other programs irrespective of who does the auditing or whether it is done by one group or by several groups.

NATURE

Those who study the newly published standards will readily detect some similarities to the generally accepted auditing standards of the AICPA. Some of these standards

are basic to any audit--for example, those pertaining to proficiency, independence, due professional care, adequacy of planning, proper supervision, and sufficiency of evidence to support opinions, judgments, conclusions, and recommendations.

Other standards which are not so readily identifiable with those of the AICPA, call for:

- . A review of compliance with legal and regulatory requirements. This requirement is most important in reviewing government operations.
- . An extension of the evaluation of the internal control system to enable the auditor to make judgments on its adequacy for insuring the production of accurate information and promoting the conduct of operations that are efficient, effective, and in compliance with applicable laws and regulations.
- . A scope of auditing that embraces not only financial and accounting operations but considerations of efficiency and economy and effectiveness of results of operations.

In addition, the reporting standards are much more numerous and detailed than those of the AICPA. This is largely because the expanded type of auditing called for requires much more in the way

of detailed audit reports than standardized opinions on financial statements or comments on financial position, operations, and procedures. The new standards, therefore, incorporate not only the AICPA standards pertaining to financial statements--with some rewording--but also contain specific standards on distribution, timing, and content of reports.

Importance of Full Scope Standard

There is no time here to review all of these standards in detail. I would like to emphasize that the most important aspect of the new standards is that relating to the full scope of a governmental audit. In referring again to such broad scope, the point needs to be underscored that the standards as stated do not necessarily require that all of this work be done in one package. Government officials may arrange for or authorize specific assignments of parts of the total work at different times and to different groups.

The main point to emphasize, however--and the explanatory discussion in the standards statement makes this point--is that those responsible for authorizing governmental audits

need to know that their full responsibility for obtaining audit work is not discharged unless the full scope of audit work as specified in the standards is performed.

Social Measurement

A major audit problem in comprehensive audits of government programs with one or more social improvement objectives is the measurement of results. The recent formation by the AICPA of a new committee to coordinate the efforts of the accounting profession to improve social measurement techniques is a very healthy and welcome development. Hopefully, it will take the lead in marshalling the talents of our profession to really dig into this difficult problem and demonstrate that professional accountants can play an important role in developing and improving these measures.

Stating Standards Only A Beginning Step

Setting standards is a desirable step in almost all management processes. In relation to governmental auditing, that step is only a beginning to the solution of the

many complex auditing problems that have evolved as governmental activities have ballooned in size and proliferated in nature, scope, and impact.

Besides setting standards there are many other questions to be faced and challenges to be met. These problems include:

- . Working out effective divisions of audit effort between different jurisdictions.
- . Making evaluations of the quality of audit work performed.
- . Providing widespread and realistic training in advanced auditing techniques.

We have 50 States and thousands of other governmental jurisdictions involved in Federal grant programs alone. Management concepts, systems, and methods vary widely among them and these differences affect the audit function. As a result, there is a wide range of differing viewpoints and attitudes to try to reconcile.

Erecting a framework of standards of audit performance for all to work within is certainly a necessary early step to getting anywhere. Professional auditors at all levels

should be able to agree on general objectives and standards. In other words, they ought to be able to agree on the kind of auditing systems that we ought to have.

IMPORTANCE OF AUDIT PROGRAMS

The newly stated standards are general in nature, as they should be. In carrying out a specific audit assignment, however, we have to get more specific as to what is to be done and such planning can be a most challenging task. Clinton T. Tanimura, the legislative auditor in Hawaii, brings out this point very well in a recent discussion of auditing of program effectiveness. He said:

We formulated general standards for the conduct of effectiveness audits but found that the standards, by themselves, were insufficient guidance to our auditors. Our approach now is to require detailed specifications to be prepared for every audit we conduct. This involved not only defining the nature and specific scope of the audit but developing in each case a framework, including program objectives and effectiveness measures, by which the program is to be assessed.¹

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See his article "State Approaches to Performance Auditing" in Governmental Finance, August 1972.

What he is saying of course is gospel to all auditors. There are no easy overall rules to follow on any audit assignment. There is a framework of general standards within which to work but a tailor-made audit program for specific assignments has to be prepared to guide the auditor toward whatever audit objective he is pursuing.

AUDITING IN THE PUBLIC INTEREST

As auditors, we have to recognize that what we do in the public area is for the benefit primarily of the public and it has the right to demand that we do what they think we ought to do--namely, evaluate and report on performance and accountability of all kinds--financial, managerial, and functional.

The pressure for expanded auditing comes primarily from users, not from auditors. In GAO's case, the Congress itself over the years has fixed the dimensions of the auditing effort and that body--in its collective wisdom as some are prone to say--has often been ahead of us in spelling out what was wanted. This is also happening in State and local governments here and there and I feel confident that these pressures will continue to build up.

Today, GAO's audit work is reflected in hundreds of audit reports prepared for the Congress and Federal agency officials each year. Most of them are publicly available documents and they contain evaluations of all kinds of management performance in the almost limitless range of Federal agency activity.

Within recent weeks, you will find reports completed and published on such varying activities as:

Regulation of users of radioactive materials

Medicare payments

U.S. financed projects in India

Inter-American Development Bank projects and activities

Test and evaluation processes in the acquisition of
major weapons systems

Use of the Federal telecommunications system
by military installations

Administration of the Federal Coal Mine and Safety Act

The Teachers Corps program

Increasing U. S. exports through better foreign market
analyses.

Highway safety improvement

Housing codes

Self-insurance practices in the Federal Government

The space shuttle program

The list is almost endless in terms of variety of activity that GAO auditors review. I should like to note also that some good advanced audit work is being done by auditors in the Federal executive agencies.

In mentioning the GAO reports, I feel impelled to also note that we do not have all of the answers by any means on how to make useful evaluations of performance in complex governmental programs. In many ways, the program evaluation art is in a very primitive stage. But it is a needed function and the auditing profession should be a major factor in carrying it out or in evaluating how it is carried out. The auditor's function is basically one of evaluation and all we are discussing here is extending it beyond the traditional financial arena.

CONCLUDING REMARKS

In closing, I have one further observation: A major part of our interest in developing a more comprehensive statement of auditing standards is to stimulate a strengthening of the audit function in State and local governments and thereby promote a scope of auditing in all jurisdictions

that will be more fully responsive to the interests of management and legislative officials and the public. The Comptroller General, Elmer B. Staats, underscored this point when the new statement of standards was issued. He stated:

We are hopeful that these standards will foster broader and more responsive auditing at all levels of government, and that they will be a real force for improvement in those State and local governments that still are performing financial audits of limited scope and are not responding to the needs of users for more and better information on public programs.

Our goal is constant improvement in the quality of auditing of governmental operations. Issuance of our new statement of standards is one small step in that direction.